

International  
Support  
Policies  
to  
South-East  
European  
Countries

Lessons  
(Not)  
Learned  
In

## CHAPTER V

### FIKRET ČAUŠEVIĆ

#### EMPLOYMENT AND PRIVATIZATION

##### **1. Preconditions for the Realization of Reconstruction Projects as a Basis for Post-War Employment Growth**

In the 1990s, the economic position of B-H was marked by the dissolution of the former SFRY and the worst war in Europe since the end of World War II. Huge devastation in the period 1992-1995 left behind horrific consequences in terms of human resources, the most important factor of competitive advantage in any country. The scope of destruction of B-H necessitated the involvement of the international community into the reconstruction process. The level of destruction of infrastructure, public utilities and housing directed most of the donor funds towards the reconstruction of these sectors, in order to create preconditions for normalization of everyday life. Even during the war, B-H was undertaking 'enrolment exams' in order to enter international financial institutions. In view of that objective, in August 1994, a monetary reform was conducted in co-operation with the representatives of IMF. The then war-time hyperinflation, conditioned by continued issuance of currency in order to cover the budget expenditure was stopped with the introduction of the new B-H dinar and its fixed value set against the German mark (100:1). This test was completed successfully. The domestic currency exchange rate was maintained at the same level, inflation-affected financing of public spending was prevented, and the currency market situation was stabilized.

Following the signing of the Dayton Peace Agreement, B-H first became a member of IMF (December 1995), then the World Bank (April 1996). Membership of B-H in the World Bank was the precondition for the First Donor Conference and the beginning of reconstruction of B-H. Total value of projects completed and under way, realized with donor funds was 5.3 billion BAM [convertible marks] (1996-June 2000).

**Table 1. Overview of Donor Assistance to B-H - 1995 - 1 June 2000**

No.	S E C T O R S	V A L U E      O F      P R O J E C T S C O M P L E T E D   O R   U N D E R   W A Y	
		BAM	%
1	Housing construction	858,718,694	16.11
2	Energy/power	692,271,956	12.99
3	Transport	595,715,080	11.18
4	Water supply	416,135,530	7.81
5	Social security support	364,341,280	6.84
6	Education	230,430,129	4.32
7	Business sector credit lines	437,311,529	8.20
8	Agriculture	203,487,487	3.82
9	Development of state institutions	209,952,469	3.94
10	Foreign debt repayment	234,579,847	4.40
11	Other	1,086,258,428	20.38
	T O T A L	5,329,202,429	100.00

**Source:** International Management Group Databases, Summary Report: Donor Aid to B-H, in: *Economic Task Force Secretariat*, Vol. 3, Issue 5.

## 2. Problems of Numbers and Structure of the Employed and Unemployed

The pace of realization of reconstruction projects dictated the terms and possibilities of employment growth. As most of the reconstruction projects were completed in the time period 1996 - mid-1999, with the exception of projects under way, the primary sources of employment growth in late 1999 and during 2000 were transferred from reconstruction to investment in the business sector. On the other hand, the structure of employment differs considerably according to the official data and according to estimates of the formal vs. informal sector. According to the December 2000 data, the official employment figures for FB-H and RS were as follows:

**Table 2. Employment and Unemployment in Bosnia-Herzegovina**

REGION	XII 1999	XII 2000	2000/1999 %
<b>Federation of B-H</b>			
- employed	410,104	412,805	0.66
- unemployed	261,793	267,934	2.35
<b>Republika Srpska</b>			
- employed	230,000	228,834	-0.51
- unemployed	147,497	153,264	3.91
<b>Bosnia-Herzegovina</b>			
- employed	640,104	641,639	0.24
- unemployed	409,290	421,198	2.91

**Sources:** FB-H Statistics Institute, *Statistički podaci o privrednim/gospodarskim i drugim kretanjima*, February 2001, p. 59; RS Employment Bureau; Central Bank of B-H, Bulletin No. 4/2000; Central Bank of B-H: *2000 Annual Report*, February 2001, p. 24.; table from: UNDP, *Early Warning System in B-H - 2000 Annual Report*.

Analysis of the number and structure of the employed and the unemployed reveals two major problems. **The first problem** is related to the qualification of the unemployed. Namely, the structure of the unemployed in both entities is dominated by persons with no or very low qualifications, as well as persons who obtained their qualifications in the period before the war. In the context of changed market environment and total openness of the B-H economy, applicability and real needs for the skills of this category of the unemployed are a huge problem for the institutionally underdeveloped labor market in B-H. Attempts of the state to assume part of the responsibility for creating preconditions for the employment of these categories are reduced to the available (insufficient) sources of funding (potential) for training programs aimed at re-qualification or additional job training in accordance with the labor market demands. The problem of organizing re-education or additional training programs is reflected in the fact that the existing employment bureaus are, in fact, not the institutions that serve the development of the labor market. Requests for labor submitted to the FB-H Employment Bureau are between 2000 and 3000. On the other hand, the gray market supply and demand are formed outside any control, so that there is no official institution that may offer even an estimate of the real labor demand and supply trends. There is an evident urgent need to develop labor exchange, which may institutionalize the labor supply and

demand. This institution may offer the possibility of a more successful definition of the additional job training, re-education or new qualifications programs, which could be supported by entity and/or cantonal employment bureaus.

**Table 3. Qualifications Structure of the Unemployed in Bosnia-Herzegovina - December 2000**

- in %

Qualification level	Federation of Bosnia-Herzegovina	Republika Srpska
Higher education	1.07	1.16
College education	1.06	1.75
Secondary education	19.63	24.68
Primary education	0.80	0.00
Highly skilled labor	0.74	1.60
Skilled labor	33.67	36.50
Semi-skilled	5.08	3.27
No skills	37.95	31.04
<b>T o t a l</b>	<b>100.00</b>	<b>100.00</b>

**Sources:** FB-H Statistics Institute; RS Employment Bureau.

**The second problem** lies in the fact that employment figures in both entities are considerably overestimated, in view of the real economic job sustainability. This conclusion is supported by the following facts. Of the registered 412,805 employed in FB-H in December 2000, 40,262 had 'on-hold' status. An even greater problem is business insolvency, mainly in the state sector. According to the Federation Statistics Institute, the number of employed who have received their January 2001 salary was approximately 267,000. Comparing this with the number of the officially employed, deducting from it the labor 'on-hold' clearly demonstrates that of the 372,543 effectively employed over 100,000 did not receive a salary for two or more months. Only with this fact in mind the picture of sustainability of jobs in a large number of state-owned businesses becomes clearer. In RS, also, of the total of 228,804 registered employed, most of them are in state-owned enterprises. The problem of surplus of registered employees in relation to the real needs bears a direct impact on the economic sustainability of these enterprises in the post-privatization period.

Causes of this situation cannot be analyzed outside the reconstruction and business sector development, circumstances surrounding the privatization of state-owned companies, development levels and business philosophy of the finance sector in B-H, level of development and quality of work of the executive, legislative and judiciary authorities in both entities, economic-political environment of B-H and powers afforded to different levels of authority in accordance with the Dayton Peace Agreement. Analysis of the concentration of the employed officially registered in both entities shows that industry, agriculture and trade encompass the largest number of the registered employed, excluding the public sector. Over 70% of the registered employed in industry and approximately 40% of the registered employed in trade are employed by state-owned companies currently being privatized. The characteristic of employment structure in RS is that a considerable part of the total

employed are in agriculture. Contrary to trade and industry, this business activity is mainly privately owned and is based on low-productivity family-owned farms.

### 3. Employment, Unemployment and Privatization

Problem of the employment surplus in state-owned industry and trade is reflected in the fact that the process of restructuring of these companies could not even commence, as the general attitude of international experts and local politicians charged with creation of economic development policy was that (mass) privatization should happen first, only to be followed by restructuring. Argument in favor of this view was based on the belief that rapid privatization will allow the establishment of new management structures which would then implement the restructuring programs. Mass privatization, i.e. exchange of certificates/vouchers with company shares was accepted as the main method of privatization. This approach implies an already developed level of knowledge and skills, developed methods of corporate management and an established capital market. In the material of the World Bank the danger of ethnic privatization was acknowledged, but it was assumed that a free equity market would be capable of decreasing or even eliminating this problem:

***"Privatization in BiH could also be complicated by the implications for ultimate if not immediate ethnic identity of ownership. A free market in enterprise equity could result in some enterprises in one ethnic-majority area falling under the ownership of persons not members of that same majority. This would be a very promising development if accepted by all parties, especially if numerous enterprises came to be owned or managed by persons from two or all of the major ethnic groups."***<sup>1</sup>

This view, as well as the general approach to mass privatization in B-H rests on the following basic assumptions:

1. existence of a free equity market and quoting shares of most enterprises on the market;
2. existence of demand for equity on the free equity market; and
3. existence of efficient company management structures.

Unfortunately, none of the three above assumptions exist in B-H.

**1) The first assumption**, the existence of a free equity market realistically cannot even be considered. As the World Bank text refers to the future, establishment of a free equity market may logically be expected. However, a free equity market is not provided for in the current legislation, as it was passed on the level of the entities, as a consequence of the privatization laws which had also been passed on the level of the entities. With an assumption that this shortcoming will be eliminated in the near future, a free equity market will imply the development of institutional capacities, which will allow for an effective functioning of the equity market. Effective functioning of the equity (capital) market presupposes the existence of the following conditions:

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<sup>1</sup> World Bank Operation Evaluation Department, *Bosnia-Herzegovina - Post Conflict Reconstruction*, The World Bank, Washington, 2000, p. 56.

- a) there are no obstacles for entry into the market that may impact the exclusion of any market player;
- b) there is developed competition, which implies that the market players are weak enough not to be able to influence price formation, either individually or as a group;
- c) financial property is divisible;
- d) transaction costs and bankruptcy costs are low;
- e) all the information available is also accessible to all the players, with low cost of use of that information; and
- f) there is no asymmetry of tax systems, i.e. tax treatment of capital gains.

Of the above generally accepted terms of effective functioning of a free equity market, just one exists (divisibility of equity capital into low nominal value shares). All other terms imply very arduous and intensive work, even radical changes of key provisions of the B-H Constitution.

**2) The second assumption** that the above World Bank view is based upon, sufficient equity demand, rests on the belief that there is a sufficient number of successful businesses whose shares, consequent to good trading, are in considerable demand. According to the results from the past two years, a mere 10% of the state-owned or majority state-owned companies achieved results that would allow them to see a considerable demand for their shares. However, enterprises that were successful in the previous period were well managed, so they do not have the problem of sustaining the current employment with regular payment and a moderate salary increase. The problem will arise in the demand for shares of a large number of companies to be privatized through mass privatization, but which will not have sources for restructuring and sustainable growth, and thus there will be no considerable interest in buying shares of those companies. On the other hand, the fact is that some of the enterprises currently showing poor results have considerable potential. However, due to the lack of transparency of the process and inaccessibility of information needed for effective assessment of investment potential, there is no possibility to assess the effect of purchase of equity and establishment of shareholders' boards, supervisory boards and multinational management teams, all of which may be beneficial to both the shareholders and the employees.

**3) Finally, the existence of effective management structures**, as the third assumption, is rather problematic, as most post-privatization companies will have to deal with restructuring problems, of which maintaining the existing employment level is for most companies in collision with the possibility of maintaining economic effectiveness and sustainability. There will be no interest for enterprises with numerous problems and conflicting goals, and thus there is a relatively high probability that it will not be possible for such enterprises to establish effective management structures as the basis for successful decision-making and sustainability of profit potentials and employment levels.

As there is a clear knowledge deficit in B-H in all these three areas, and in view of the fact that a period of several years is required for the players in the privatization process to acquire the necessary knowledge, the time that has passed has shown that the learning process is not as rapid as expected<sup>2</sup>. Taking into

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<sup>2</sup> The World Bank texts dealing with post-war reconstruction of B-H used the examples of Germany and Lebanon to prove that rapid recovery with high rates over a longer post-war period. However, a comparison of B-H with these countries is useless, since Lebanon, and even more so Germany, had a

account the structure of power, in which the local authorities are given considerable duties which they were unable to perform effectively, due to the selection and suitability system which places knowledge at the very bottom of the list, i.e. less important than 'honesty', the build-up of unresolved problems is not surprising. Even with more effective and better qualified management structures, the gravity of the problem and the span of knowledge that had to be adopted required a period of at least two years. An alternative concept of tender privatization and direct sale, primarily of medium and large companies with the highest numbers of employees, was not even considered as an option until late 1999. However, by then most of the state-owned companies were already in a very difficult situation, with a very low turnover index, which, along with very expensive sources of working capital, bore a direct impact on the growth of losses and growing insolvency. Impossibility of regular payment of salaries decreased the standard of living of the employees, and the reaction in terms of protection of rights of the employees and the guaranteed level of minimal payment was the signing of collective contracts. The signing of collective contracts introduced a new paradox to the field of competitiveness. This paradox will be explained through the example of the Federation of B-H.

#### **4. Institutional Regulation of the Labor Market and Problems of the Grey (Black) Market**

The signing of the General Collective Contract between the Union of B-H as the representative of the employees, and the Government of FB-H as the owner and employer in majority state-owned enterprises<sup>3</sup>, was followed by the signing of the branch collective contracts between branch unions and the Government of FB-H (16 branch collective contracts). Provisions of these contracts are in accordance with the provisions of the Labor Law<sup>4</sup> in regard to the protection of the rights of the employees (lowest guaranteed salary, salary scales, compensation, severance pay, etc.). However, the key labor market problems are reflected in the fact that these provisions are binding only for the signatories of the contract, i.e. companies with majority or 100% state-owned equity. General Collective Contract and branch contracts were not signed by employees and employers in majority privately owned equity companies, thus bringing state-owned enterprises to an unfair position, since taxation and benefit rates are calculated on different bases (much higher for the state sector). As more than 66% of the total employed are in the state sector, the total expenditure has a direct impact on the creation of serious balance sheet problems, arising from accounted for yet unpaid salaries, and unpaid social benefits. An additional problem is the creation of the illusion of growth of GDP, as the annual reports of enterprises quote the salaries calculated, which the statistics institutes then use to calculate the GDP.

These problems create the basis for a huge gray market. The estimated ratio of gray market employees versus the officially employed is 0.75:1 or, in other words, the supply in the gray market reaches 75% of the total number of the registered employed. Sources of supply in the gray market are persons who are officially employed 'on-hold', officially registered unemployed, persons who have not received a salary for two or more months, and persons who are not even registered as unemployed (primarily refugees and displaced persons). On this basis, over 350,000 persons offer their services on the gray market in FB-H (267,000 officially

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developed market economy and a high level of knowledge in the field of financing. B-H cannot be compared with these countries.

<sup>3</sup> Official Gazette of the Federation of B-H, No. 19/00.

<sup>4</sup> Official Gazette of the Federation of B-H, No. 43/99 and 32/00.

unemployed, 40,000 employees 'on hold', 50,000 employees with salaries delayed by two or more months), and in RS over 230,000 (154,000 officially unemployed, 80,000 persons with delayed salaries and persons who are not registered as unemployed). The following table shows estimated unemployment rates, taking into account employees 'on hold', employees who have not received a salary for two or more months, persons employed in the gray market, and net effects.

**Table 4. Estimated Unemployment Rate in Bosnia-Herzegovina**

	DESCRIPTION	FB-H	RS	B-H
	as of (date):	31.12.2000.	31.12.2000.	31.12.2000.
1	Estimated population	2,400,000	1,450,000	3,850,000
2	Estimated fit-for-work population aged 15-64	1,650,00	970,000	2,620,000
3	Total labor available	940,000	560,000	1,500,000
4	Officially employed	412,805	228,834	641,639
5	Registered unemployed	267,934	153,264	421,198
6	Employed 'waiting on hold'	40,262	32,000	72,262
7	Employed with salary delayed for two or more months	95,000	65,000	160,000
8	Persons employed in the gray market for three or more months	200,000	120,000	320,000
9	Strict unemployment rate $(5 / 3 \times 100)$	28.5%	27.4%	28.1%
10	Unemployment rate including labor 'on hold' $((5+6) / 3 \times 100)$	32.4%	33.1%	32.9%
11	Potential unemployment rate including the employed with delayed salary payment $((5+6+7) / 3 \times 100)$	42.9%	44.7%	43.6%
12	Unemployment rate including gray market employment $((5+6+7-8) / 3 \times 100)$	21.6%	23.3%	22.2%

**Sources:** Federation Statistics Institute, *Statistički podaci o privrednim/gospodarskim i drugim kretanjima*, No. 2/2001, pp. 52-57; Central Bank of B-H, Bulletin 4/2000, pp. 47-49; estimates of population, age structure, employees 'on hold' in RS, number of persons who have not received a salary for two or more months and estimate of supply of labor in the gray market are all by F. Čaušević.

A comparison of the total supply of labor in the gray (black) market and the official employment numbers in both entities shows the entire paradox and the gravity of the problem. According to the above estimates, 580,000 are offering services in the gray labor market, compared with 641,646 officially registered employed. The paradox is even greater in view of the fact that of the total gray market labor supply, at least 170,000 persons are from the 'official' sector, i.e. the



sector which is subject to the application of the laws on fiscal contributions, and over 50% are subject to the terms of collective contracts, thus increasing the fiscal expenditure of the 'official' sector. Estimating that of the total gray market supply, over 320,000 persons are really engaged for three or more months, the public revenue losses arising from unpaid social benefits and taxes may be estimated at 250-300 million BAM (with an assumption that employers register a minimal salary of 200 BAM and pay 150 BAM in taxes and benefits for each employee engaged for longer than three months).

## 5. Problems of Application of Legislation to the Labor Market and Economic Capabilities of the Business Sector

In addition to the above-mentioned problem of application of provisions of the General Collective Contract and branch collective contracts in FB-H and RS, the economic inapplicability of legal provisions will be illustrated with an example of the application of provisions of the Labor Law in FB-H. Article 143 prescribed that for all employees registered 'on hold', this status was to expire six months after the law had come into effect, i.e. May 5, 2000, unless the employer invites them back to work. Persons who were employed on December 31, 1991 and failed to report to the enterprise (employer) after the end of the war in B-H were entitled to address the enterprise in writing and request to return to work no later than three months after the law had come into effect (by February 5, 2000), provided they had not entered full employment elsewhere in the meantime. If the employer had no possibility or no need to re-hire such persons, he had to register them as employees 'on hold'.

Pursuant to paragraph 4 of this Article, the employer who did not invite a person registered 'on hold' back to work by February 5, 2000, thus terminating the employment, was obliged to pay a severance in the amount of three average salaries paid in the Federation of B-H in the three preceding months, according to information on average salaries published by the Federation Statistics Institute. Persons entitled to this amount of severance pay were those who had had registered full employment with all benefits paid for five years. For each successive year, the employer was obliged to pay no less than one half of the average monthly salary. As the official average net salary for the Federation of B-H in the time period February - April 2000 was 402 BAM, the total severance pay for all of the 52,500 registered employed 'on hold' would amount to 116,08 million BAM, assuming an average of 10 years of registered employment of persons employed 'on hold'<sup>5</sup>.

In view of the growing insolvency of companies, delays in payments to effectively employed staff, expensive sources of financing for current solvency and the necessary working assets of companies, employers were unable to pay severance to employees 'on hold' whom they failed to invite back to work, and who were to be terminated on May 5, 2000. The impossibility of application of Article 143 of the Labor Law was pointed out as soon as the law was published. A consequence was that the provisions were not applied in practice. The category of employees 'on hold' is still included in all the official publications and company reports. In the meantime, a Law on Changes and Amendments to the Labor Law was adopted, and it decreased considerably the commitments of the company in relation to severance pay, thus allowing for a more rapid decrease of employees 'on hold' in the time period September 2000 - March 2001 in comparison with the entire preceding year (Changes and Amendments to the Labor Law came into force in September 2000).

## 6. Problems Noted

Problems of promoting employment growth cannot be seen outside the context of views of reconstruction, privatization and reform of the finance sector. Reconstruction projects were the basis of employment growth in the post-war period. At the end of these projects, sources of employment growth ceased to exist. Labor supply and demand in the private sector is dictated by the possibility of

<sup>5</sup> Fikret Čaušević, "Specific Aspects of Labor Market in the Federation of B-H", in: the World Bank: *Labor Market in Bosnia and Herzegovina*.

providing financing for the realization of investment projects and the quality of management. As the loan agencies preferred small and medium privately owned enterprises, restructuring of medium and large companies with majority state ownership was left as a post-privatization task. The privatization process could not be carried out in a time as short as advocated by numerous domestic and international experts. Namely, in view of the need to establish an institutional network and structure to allow for an effective privatization, the realization of this job requires a period of at least two to three years. (Polish experience is particularly relevant within this context.) The starting position that privatization of small enterprises and parts of enterprises should happen first, and then use mass privatization to privatize medium and large enterprises led to delays in dealing with key issues of economic development of Bosnia-Herzegovina - restructuring of enterprises which employ 60% of the officially employed workforce. This problem received attention only three years after the first Draft Law on Privatization of Enterprises, with the establishment of the International Advisory Group and the Tender Bureau.

Meanwhile, directors and boards of managers of state-owned enterprises were appointed on the basis of political rather than professional criteria. As the managers of state-owned enterprises were of inadequate qualifications and insufficient knowledge on the one hand, and with objective limitations in managing these companies due to social policies on the other, the economic future and sustainability of jobs has become uncertain. A dichotomy of ownership structure and the passivity of the domestic judiciary and international representatives has been created in relation to the obvious abuse of power of managers of state-owned enterprises, reflected in transfer of clients and business partners to private enterprises founded by relatives or business associates, which led to insolvency of a huge percentage of the state-owned business sector. General and branch collective agreements between entity governments and entity unions put state-owned enterprises into an unfavorable position in relation to the private-owned companies, as the provisions of these contracts are applied only to companies with majority state ownership. The end of the privatization process will not resolve the problem, as the buyers of privatized companies will also assume all previous commitments.

## **7. Recommendations**

7.1. The solution to these problems requires prompt action aimed at accelerating tender sales with a more active engagement of agencies responsible for privatization, entity governments and international advisory groups.

7.2. One of the priorities should be the establishment of companies which will serve as a direct link between enterprises in the privatization process and possible investors. Another is the establishment of restructuring companies with a share of the founding capital held by international financing institutions, and which would be directly engaged in the restructuring process, by providing the necessary know-how, technology and links with foreign markets.

7.3. Entity governments should consider possibilities of financial restructuring of majority state-owned enterprises. The most important goal of such restructuring is to settle all debts and receivables wherever possible, and to transform short-term liabilities into long-term ones, with economically realistic repayment terms.

7.4. Labor market reform implies clear definitions of rules on minimum guaranteed salary, supplements and other rights arising from the Labor Law and their application to all business activities irrespective of the ownership structure. The existing situation, with rights of the employees loosely defined in the Labor Law, and specified in general and branch collective contracts applied to majority state-owned enterprises, facilitates the creation of a large gray labor market and undermines the possibility of economic sustainability in medium and large enterprises.

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